SUBJECT: (Optional)

Lines of Credit for the Soviet Union

FROM:	EXTENSION	NO.
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		DATE 8 November 1988

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The Director of Central Intelligence

Washington, D.C. 20505

National Intelligence Council

NIC 03269-88
8 November 1988

MEMORANDUM FOR: Director of Central Intelligence

FROM: Deane E. Hoffmann
National Intelligence Officer for Economics

SUBJECT: Lines of Credit for the Soviet Union

1. Action: None; this is background information on Soviet borrowing activity. You may find the information useful during the visits of Prime Minister Thatcher and Chancellor Kohl.

2. Newspapers report that the Soviets have recently arranged lines of credit totaling around $9 billion, implying that the USSR is on a credit binge. The Soviets have actually signed two agreements so far -- for 3 billion DM (equivalent to US $1.7 billion) from West Germany and about $775 million from Italy. Other loans are being discussed with banks [redacted] These lines all appear to be at commercial rates, although we will not be certain until the agreements are signed. Some of the lines are tied to purchases of equipment related to the production of consumer goods. 25X1 25X1 25X1

3. My belief is that the credit lines are tied both to potential imports of machinery and to Soviet attempts to sign joint ventures. Western firms remain reluctant to shoulder much of the financial burden of these ventures. With credit lines in hand, the Soviets will be in a stronger barganing position since they will be able to offer to purchase some equipment and other goods for the joint operations. On the political front, the credit lines allow Gorbachev to stimulate a competitive atmosphere among Western governments to help perestroika. Further, he is able to show Soviet consumers that Moscow intends to foster new industries to produce consumer goods. As SOVA points out in its analysis, the key to watching the progress on these credits is to track Soviet orders for Western machinery.

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4. The new credit lines do not alter, in my view, the judgment that Moscow will be prudent on its use of credit to boost economic performance. Under Gorbachev, the Soviets have not increased their net foreign borrowing so far, and Gorbachev understands that extensive use of borrowing, while offering little overall economic benefit, could hamstring future flexibility to purchase imports and to extend foreign aid. Given the economic and political uncertainties that lie ahead for the USSR, however, Soviet views on the use of credits could change. Hence, we need to be vigilant for a shift to a more liberal credit policy.

5. In sum, I see nothing in the announcement of these loans that they are a litmus test indicating that our Allies have decided to "support" perestroika. The test on that issue is in other areas such as the nature of the commercial deals struck and the pressures these deals might put on COCOM regulations. My belief is that the Coordinating Committee on Multilateral Controls (COCOM) is in for very rough sledding over the next four years.

Deane E. Hoffmann

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Attachments:
A. DI/SOVA Table
B. State/INR Analysis

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WESTERN LENDING TO THE USSR

The Soviets are seeking greater financing to boost imports of equipment for consumer industries, and the West has responded favorably with new credits. Despite the political rhetoric surrounding the credits, the primary western objectives are to promote exports and secure access to the Soviet market. Where applicable, OECD guidelines and the allied consensus rules would apply—the credits are tied to exports and bear market interest rates. Lenders are not likely to allow an increase in the USSR's debt to a point that would threaten western economic interests. The availability of external credits, meanwhile, will not necessarily contribute to increased Soviet defense spending.

New credit

Approximately $9 billion of new western credit to the Soviet Union is under consideration. Thus far only the $1.7 billion Deutsche Bank credit, which has no government guarantee, and the $775 million Italian credit have been finally agreed. The proposed $1.7 billion UK loan awaits a decision on terms by the seven British banks involved; the ECGD will consider guarantees on a case-by-case basis. French and Japanese credits of approximately $2 billion each are still in the early stages of negotiation and may not be completed until 1989.

These lines of credit appear to be valid for two to four years. The credits themselves would be drawn on over several years as specific trade deals are negotiated. Interest is to be at commercial market rates, and known repayment periods will range from 5 to 8.5 years. Some uncertainty surrounds the interest rate and government guarantees for the Italian credit; Italian officials have said, however, the treasury ministry will not subsidize lending to the USSR.

The western perspective

Western political interest in and support for reforms in the Soviet Union notwithstanding, the motivation behind the recent surge in credit to the USSR is largely economic. Should Soviet reforms lead to a significant opening of the economy, western firms want to be in a position to secure access to the Soviet market to promote their exports.

Despite their rush to take advantage of new opportunities in the USSR, western lenders have not sacrificed sound business practices. On the contrary, the strong Soviet payment record makes it one of the more appealing lending alternatives in recent years. (By international rating standards, the USSR outranks all but 20 countries in the world.)

Soviet motivations

The Soviets hope to replace existing credit lines with arrangements that take advantage of the OECD decision in July 1988 to charge market interest rates for guaranteed export credits for the USSR. Market rates are now lower than the previous, fixed OECD rate. The Soviets hope also to increase imports of capital goods to compensate for reductions taken over the last few years. Their primary goal is to retool their consumer and light industries with better western equipment, in concert with domestic efforts to restructure these sectors.

The Soviet debt profile will accommodate additional borrowing. From 1988 to 1990, the Soviets are expected to increase their net debt (apart from exchange-rate effects) by an estimated $7-10 billion, raising their debt-service ratio from the current 24% to 27-30% in the early 1990s

Security implications

Western lenders closely follow the Soviet debt situation and pace their lending accordingly. Bankers consider the USSR primarily a commodity exporter that could not readily increase export revenues to pay off a high debt burden. The Soviets do not want to become overly dependent on western credits. Moreover, their rate of borrowing will be tempered by how efficiently they think they can use imported capital equipment. The Soviets are not likely to default on their debts.

Illicit Soviet purchases of military technology are limited more by the availability of such items in the West than the Soviet ability to pay for them. Increased western lending alone would not allow the Soviets to boost their acquisition of controlled technology.

Nor will defense spending benefit from external credits, since the Soviet system of allocating resources rather than rubles for investment does not allow for easy transfer from one sector to another. Even if it did, some investment would have to be made to produce goods for export to earn the hard currency to repay the loans plus interest. Furthermore, Gorbachev appears determined to have the defense sector help the consumer sector whether or not the consumer sector receives outside credits.
(SECRET/NOFORN/NOCONTRACT/ORCON)

SECRET NOFORN NOCONTRACT